No. 91-42

In the Supreme Court of the United States

OCTOBER TERM, 1991

UNITED STATES OF AMERICA, PETITIONER

v.

THERESE A. BURKE, ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES

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QUESTION PRESENTED

Whether payments received in settlement of back-wage claims under Title VII of the Civil Rights Act of 1964 are excluded from the claimant's gross income under Section 104(a)(2) of the Internal Revenue Code as "damages received * * * on account of personal injuries or sickness" (26 U.S.C. 104(a)(2)).

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-17a) is reported at 929 F.2d 1119. The opinion of the district court (Pet. App. 18a-34a) is unofficially reported at 90-1 U.S.T.C. ¶ 50,203.

JURISDICTION

The judgment of the court of appeals was entered on April 5, 1991. The petition for a writ of certiorari was filed on July 5, 1991, and was granted on October 7, 1991. The jurisdiction of this Court rests upon 28 U.S.C. 1254(1).

STATUTORY PROVISION INVOLVED

Section 104 of the Internal Revenue Code, 26 U.S.C. 104, provides in pertinent part:

> Compensation for injuries or sickness
>
> (a) In General.
>
> Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include—
>
> * * * * *
>
> (2) the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness;
>
> * * * * *

STATEMENT

1. Respondents are employees of the Tennessee Valley Authority (TVA) and members of the Office and Professional Employees International Union, AFL-CIO (OPEIU).[1] In 1984, Judy A. Hutcheson, a TVA employee, filed an action alleging that TVA had engaged in unlawful sex discrimination in the payment of salaries, in violation of Title VII of the Civil Rights Act of 1964, 42 U.S.C. 2000e *et seq.* OPEIU intervened in the action in its representational capacity on behalf of respondents and other employees of TVA. Pet. App. 2a; C.A. App. 16.[2]

[1] Respondents are Therese A. Burke, Cynthia R. Center, and Linda G. Gibbs.

[2] References to C.A. App. in this Brief are to the appendix filed in the court of appeals.

Hutcheson and OPEIU alleged that TVA discriminated against female employees in 1981 when it increased the salaries of employees in male-dominated pay schedules and either left salaries of employees in female-dominated pay schedules unchanged or lowered them. Pet. App. 2a-3a; C.A. App. 20-34. The complaint alleged that TVA had "a policy and practice of unlawful, gender-based discrimination with respect to salary" (Pet. App. 20a; C.A. App. 27) and that its conduct was "intended to and did result in disparate treatment of its female employees in their rates of pay in violation of Title VII of the Act" (Pet. App. 22a; C.A. App. 32). The plaintiffs sought an order restraining further discrimination and "a further order awarding back pay to all affected female employees * * * in an amount * * * sufficient to eliminate discrimination" (Pet. App. 22a; C.A. App. 34).

TVA filed a counterclaim against OPEIU alleging fraud, misrepresentation, breach of contract, conspiracy with intent to defraud TVA, and interference with contractual relationships. Pet. App. 3a; C.A. App. 35-56. After the plaintiffs' claim and TVA's counterclaim survived motions for summary judgment, the parties agreed to settle the case. Pet. App. 3a. Pursuant to the settlement agreement, TVA agreed to pay $4200 to Hutcheson and a total of $5,000,000 to affected TVA employees under a formula based on length of service and rates of pay (*id.* at 3a, 23a; C.A. App. 76-77).[3] It was stipulated,

[3] The settlement agreement was signed on March 13, 1987 (Pet. App. 23a; C.A. App. 68-75), and an amendment to the agreement was signed on May 6, 1987 (Pet. App. 24a; C.A. App. 76-79). The settlement agreement, as amended, provides that settlement payments are to be made to all affected per-

however, that TVA would distribute money to individuals only after it first withheld all applicable federal income taxes and FICA (social security) taxes from the payments (Pet. App. 25a; C.A. App. 76-77, 88).[4]

Based upon their lengths of service and rates of pay, respondents Burke, Carter, and Gibbs were entitled to receive, respectively, $764.94, $927.55, and $572.95 under the settlement agreement. TVA withheld federal income tax and FICA tax from these amounts and remitted the taxes to the United States. Pet. App. 25a. The net balance of the settlement amounts was then paid to respondents (C.A. App. 17-18).

2. Respondents filed refund claims with the Internal Revenue Service for the taxes withheld from the settlement payments (C.A. App. 7-9). The Internal Revenue Service disallowed the claims (C.A. App. 10-14). Respondents then commenced this refund action in the United States District Court for the Eastern District of Tennessee, claiming that the settlement payments should be excluded from their gross incomes under Section 104(a)(2) of the Internal Revenue Code as "damages received * * * on account of personal injuries or sickness" (26 U.S.C. 104(a)(2)). C.A. App. 2-5.

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sons who were employed "at any time between June 28, 1981, through and including March 10, 1987" (Pet. App. 25a; C.A. App. 77). The agreement further provides that the amounts to be paid to the affected employees "will be based upon pay rates and length of service * * * during the above period" (C.A. App. 77).

[4] The settlement agreement provides that "TVA will pay at OPEIU's direction a sum not to exceed $5,000,000, less any taxes which TVA may be required to pay because it is the employer of any person whom OPEIU may designate to receive a portion of said sum" (Pet. App. 24a; C.A. App. 76-77).

The district court rejected respondents' claims (Pet. App. 18a-34a). The court observed that several courts have held that Title VII back pay awards do not constitute damages for "personal injuries or sickness" (*id.* at 31a-34a, citing, *e.g.*, *Thompson* v. *Commissioner*, 866 F.2d 709, 712 (4th Cir. 1989); *Hodge* v. *Commissioner*, 64 T.C. 616, 618-620 (1975)) and that the complaint in the underlying Title VII action "makes it clear that the very core of the case was the recovery of wage deficiencies" (Pet. App. 32a). Finding that the plaintiffs had "tacitly accepted that the sums to be received under the Settlement Agreement were in the nature of back pay" (*id.* at 34a), the court concluded that the amounts received by respondents were not excluded from gross income under Section 104(a)(2) (Pet. App. 34a).

3. A divided court of appeals reversed (Pet. App. 1a-17a). The panel majority stated that the question "whether the § 104(a)(2) exclusion applies requires an examination of the nature of the injury to determine whether the injury and claim are personal and tort-like in nature" (*id.* at 6a). The court concluded that a sex discrimination claim is tort-like in nature because "injuries resulting from invidious discrimination, be it on the basis of race, sex, national origin or some other unlawful category, are injuries to the individual rights and dignity of the person" (*ibid.*). The court of appeals had previously held in *Pistillo* v. *Commissioner*, 912 F.2d 145 (6th Cir. 1990), that an award of back pay under the Age Discrimination in Employment Act, 29 U.S.C. 621-634, constituted damages for "personal injuries or sickness" excluded from income under Section 104(a)(2). The court found no basis for distinguishing *Pistillo* from the present case (Pet. App. 7a-11a) and thus concluded that "suits for unlawful discrimination under Title

VII, like suits under the ADEA and other tort type suits, fall within the category of suits for injury to the person and that the damages resulting therefrom are properly excludable under § 104(a)(2)" (*id.* at 11a).

In dissent (Pet. App. 12a-17a), Judge Wellford observed that "[t]he subject matter of the [underlying Title VII] suit was pay for work performed" (*id.* at 12a) and that respondents "obviously recovered amounts which would have been subject to income tax had they come to [respondents] in the normal course" (*id.* at 14a). Judge Wellford noted (*id.* at 15a) that the Fourth Circuit had held in *Thompson* v. *Commissioner*, 866 F.2d 709 (1989), that a Title VII back pay award is not excludable under Section 104(a)(2), because "[t]he back pay award was simply recovery for earned, but unpaid, wages" and represented "compensation for services rendered" (866 F.2d at 712). Because Judge Wellford found the Fourth Circuit's analysis of this issue "to be both logical and compelling," he concluded that the "flawed analysis" of *Pistillo* should not be extended to this case (Pet. App. 15a).

SUMMARY OF ARGUMENT

Section 104(a)(2) of the Internal Revenue Code excludes from gross income "the amount of any damages received (whether by suit or agreement * * *) on account of personal injuries or sickness." Respondents received payments from their employer as part of a settlement of an action brought under Title VII of the Civil Rights Act of 1964. The Title VII action was based on the allegation that the manner in which the employer established salary schedules for different job categories resulted in gender discrimination in the payment of salaries. The only monetary relief sought in the underlying Title VII action, and the only relief available in that action, was back pay. Amounts received in settlement of a claim are treated for tax purposes as having the same character as the claim itself. Accordingly, the amounts received by respondents are treated for tax purposes as Title VII back pay.

As this Court noted in *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 432 n.8 (1955), the rationale of Section 104(a)(2) is that no gain or profit is realized from compensation that merely restores personal "capital" lost through injury, such as an award of damages for injury to a human body or for injury to personal reputation in a defamation case. It is not supportable, however, to view the receipt of back wages (which would have been taxed as income if received currently during the course of employment) as compensation for lost personal capital. Since a Title VII back pay award such as that at issue here is not an award of damages that compensates for an injury to one's personal capital, but represents an undeniable accession to wealth in the form of deferred wages for services actually provided, it represents taxable income.

The injury suffered by respondents (and the injury for which they were compensated under Title VII) was an injury to their economic interests relating to the amount of their salaries. If respondents' salaries had been increased in the same manner as the salaries of employees in the male-dominated job categories were increased, then there would have been no Title VII violation, no injury, and no Title VII claim. The settlement payments that respondents received represent the recovery of earned, but unpaid, wages. They

therefore constitute "[c]ompensation for services" and are expressly included in gross income by Section 61 (a) (1) of the Internal Revenue Code.

The conclusion that Title VII back pay is not to be excluded from gross income is wholly in accord with the policies fostered by Title VII. The remedies available under Title VII are designed to make persons whole for injuries suffered on account of unlawful employment discrimination. A Title VII back pay award is thus designed to place the employee in the same economic position she would have achieved had she not been discriminated against in the first place. If respondents' employer had not discriminated against respondents in the present case, they would have received higher salaries, and those salaries would have been included in their gross incomes. Requiring respondents to pay taxes on their back pay awards accomplishes the objectives of Title VII by placing respondents in the same position they would have held if there had been no discrimination.

ARGUMENT

PAYMENTS RECEIVED IN SETTLEMENT OF BACK-WAGE CLAIMS UNDER TITLE VII OF THE CIVIL RIGHTS ACT OF 1964 ARE NOT EXCLUDED FROM GROSS INCOME UNDER SECTION 104(a)(2) OF THE INTERNAL REVENUE CODE AS "DAMAGES RECEIVED * * * ON ACCOUNT OF PERSONAL INJURIES OR SICKNESS"

A. Section 104(a)(2) Excludes From Gross Income Payments Received By Individuals That Restore The Losses They Suffer "On Account Of Personal Injuries Or Sickness"

The first step in calculating taxable income under the Internal Revenue Code is to determine the taxpayer's "gross income." Section 61(a) provides broadly that, subject to specific exclusions set forth elsewhere in the Code, "gross income means all income from whatever source derived." Any funds or other "accessions to wealth" (*Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 430-431 (1955)) received by a taxpayer therefore represent "gross income" unless the taxpayer establishes that the income falls within one of the specific exclusions created by other sections of the Code.

It is not disputed that the payments received by respondents in settlement of their sex-discrimination claims under Title VII of the Civil Rights Act of 1964 represent an "accession to wealth" that constitutes "gross income" within the broad scope of Section 61(a). The question presented in this case is whether these settlement payments are excluded from "gross income" by Section 104(a)(2), which provides that "gross income does not include * * * the amount of

any damages received (whether by suit or agreement * * *) on account of personal injuries or sickness." [5]

This exclusionary provision was first enacted as Section 213(b)(6) of the Revenue Act of 1918, ch. 18, 40 Stat. 1066. The purpose of the statute was to implement this Court's then-recent holding in *Doyle* v. *Mitchell Brothers Co.*, 247 U.S. 179, 183, 185 (1918), that amounts received from the "conversion" of capital assets into money represented "income" only to the extent that a "gain" was realized from the transaction.[6] "Applying this decision, the Attorney General held in an opinion, dated June 2[6], 1918, that the proceeds of an accident insurance policy were not subject to tax, the conclusion being based upon the reasoning that the human body is a kind of capital and that the proceeds of the insurance policy represented a conversion of the capital lost through the in-

[5] Section 104(a)(2) concerns exceptions from "gross income" for income tax purposes. The taxpayers in this case also seek recovery of FICA contributions (Pet. App. 18a), which are "imposed on the income of every individual" and are calculated upon an employee's "wages." 26 U.S.C. 3101(a). Neither the parties nor the courts below separately addressed whether Section 104 applies to FICA as well as income tax computations. If, as we submit, back pay received under Title VII constitutes "compensation for services" and falls within "gross income" under Section 61(a) of the Code, it also constitutes "wages" for FICA purposes. See 26 U.S.C. 3121(a) (" 'wages' means all remuneration for employment").

[6] *Doyle* v. *Mitchell Brothers Co.* was decided under the Corporation Tax Act of 1909, ch. 6, § 38, 36 Stat. 112. The Court defined income as "the gain derived from capital, from labor, or from both combined." 247 U.S. at 185 (quoting *Stratton's Independence, Ltd.* v. *Howbert*, 231 U.S. 399, 415 (1913)). Two years later, the Court used this same definition of "income" in interpreting the scope of the Sixteenth Amendment. See *Eisner* v. *Macomber*, 252 U.S. 189, 207 (1920).

jury." S. 1384, 2 C.B. 71, 72 (1920) (citing 31 Op. Att'y Gen. 304 (1918)). The rationale for the statute, which "intended to go no further" (S. 1384, 2 C.B. at 72), was thus that type of harm to the human body that gives rise to recoveries of workmen's compensation or health insurance payments, or to damage awards for "such injuries or sickness," did not represent "income" as the term was then defined. H.R. Rep. No. 767, 65th Cong., 2d Sess. 9-10 (1918).[7]

In the first ruling issued by the Internal Revenue Service under this statute,[8] it was therefore concluded that, while nonphysical injuries (such as alienation of affections) could be regarded in some sense as

[7] The Treasury had initially taken the position that amounts paid under accident insurance policies and amounts received in a suit for personal injury were includable in income. T.D. 2135, 17 Treas. Dec. Int. Rev. 39 (1915). In 1918, however, after this Court's decision in *Doyle* v. *Mitchell Brothers Co.*, *supra*, the Attorney General issued the aforementioned opinion that such recoveries should be excluded from income because they "merely take the place of capital in human ability which was destroyed by the accident." 31 Op. Att'y Gen. at 308. The Treasury then ruled that "the proceeds of an accident insurance policy received by an individual on account of personal injuries sustained by him through accident" and "an amount received by an individual as the result of a suit or compromise for personal injuries sustained by him through accident" were not income. T.D. 2747, 20 Treas. Dec. Int. Rev. 457 (1918). Congress enacted Section 213(b)(6) because "[u]nder the present law it is doubtful whether [amounts received from health insurance, workmen's compensation or as damages on account of personal injuries] are required to be included in gross income." H.R. Rep. No. 767, *supra*, at 9-10.

[8] The Internal Revenue Service was known at that time as the Bureau of Internal Revenue. For continuity of discussion, this brief refers to both the Bureau of Internal Revenue and the Internal Revenue Service as "the Service."

"personal" injuries, they are nonetheless not within the statutory exclusion from income because "the term 'personal injuries,' as used therein means physical injuries only." S. 1384, 2 C.B. at 71; see *id.* at 72.[9]

In 1922, however, the Service reconsidered whether recoveries for alienation of affections (and other nonphysical injuries to personal rights) were taxable and ruled that, while they are not excluded from income by (what is now) Section 104(a)(2), they nonetheless do not represent "income" because, when an individual receives damages that merely compensate him for loss suffered to a "personal right," "it can not be held that he thereby derives any gain or profit." S. 132, I-1 C.B. 92, 93 (1922) (citing *Eisner* v. *Macomber*, 252 U.S. 189 (1920)).[10] Because there is no gain or profit in such compensation, such recoveries were thought not to represent "income within the meaning of the sixteenth amendment and the statutes enacted thereunder." I-1 C.B. at 93-94. Thus, even though the exclusion from income afforded to compensation for "personal injuries or sickness" under (what is now) Section 104(a)(2) was not applicable to compensation received for a nonphysical injury to personal rights, the Service ruled that such compensation was not taxable because no "income" had resulted. I-1 C.B. at 93-94. See Knickerbocker, *The Income Tax Treatment of Damages: A Study in the Difficulties of the Income Concept*, 47 Corn. L. Q. 429, 430-434 (1961).

[9] While the Service thus rejected a claim that the tort of alienation of affections represented a "personal injury" within the scope of the statute, the Service recognized that "it is still possible that damages therefor might be measured in part by sickness resulting therefrom and, of course, the amount received on account of sickness would be exempt under the express language of the statute." S. 1384, 2 C.B. at 72.

[10] This ruling was issued in the form of a Solicitor's Opinion, which corresponds to a revenue ruling under modern practice. See 26 C.F.R. 601.201(a)(6).

In 1955, however, this Court made clear that the term "income" is not limited to earnings and profits from labor and capital but includes all "accessions to wealth" from whatever source derived. *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. at 431. As a result, there is now no constitutional impediment to taxing personal injury damages. See B. Bittker & L. Lokken, *Federal Taxation of Income, Estates and Gifts* ¶ 13.1.1, at 13-2 (2d ed. 1989).[11] In *Glenshaw Glass*, however, the Court did not reject the Service's longstanding position that the recovery of damages for personal claims would not represent "income" under the Internal Revenue Code to the extent that such recoveries "correspond to a return of capital." 348 U.S. at 432 n.8, citing, *e.g.*, S. 132, I-1 C.B. 92, 93.[12]

Since the decision in *Glenshaw Glass*, the proper focus for the inquiry whether recoveries for non-

[11] See also *Lukhard* v. *Reed*, 481 U.S. 368, 374-376 (1987) (plurality opinion) (a state may treat personal injury awards as "income" for purposes of determining the eligibility of families seeking Aid to Families with Dependent Children benefits).

[12] In *Glenshaw Glass*, the Court held that punitive damages are included in income. The Court noted that "[t]he long history of departmental rulings holding personal injury recoveries nontaxable on the theory that they roughly correspond to a return of capital cannot support exemption of punitive damages following injury to property" because "[d]amages for personal injury are by definition compensatory only. Punitive damages, on the other hand, cannot be considered a restoration of capital for taxation purposes." 348 U.S. at 432 n.8.

physical injuries to personal rights are subject to tax is thus whether the recovery merely represents compensation, without "any gain or profit" (S. 132, I-1 C.B. at 93), for human "capital lost through * * * injury" (S. 1384, 2 C.B. at 72). As Judge Browning stated for the court in *Starrels* v. *Commissioner*, 304 F.2d 574, 576 (9th Cir. 1962), "[d]amages paid for personal injuries are excluded from gross income because they make the taxpayer whole from a previous loss of personal rights—because, in effect, they restore a loss of capital." Accord, *Commissioner* v. *Miller*, 914 F.2d 586, 590 (4th Cir. 1990).[13] For Section 104(a)(2) to be applicable to a recovery involving a non-physical injury to personal rights, the taxpayer therefore has the burden of establishing that the recovery is reimbursement for a prior loss of personal

[13] In 1983, the Ninth Circuit held in a case involving defamation that both physical and nonphysical injuries are encompassed within the Section 104(a)(2) exclusion. See *Roemer* v. *Commissioner*, 716 F.2d 693, 697 (9th Cir. 1983). See also Pet. App. 5a (adopting same reasoning). The only support offered for this holding in *Roemer* was that the 1922 Solicitor's Opinion had concluded that recoveries for nonphysical injuries did not represent "income." See 716 F.2d at 697 (citing S. 132, I-1 C.B. at 92). As we have shown, however, the 1922 Solicitor's Opinion had instead observed that nonphysical injuries were not encompassed within the statutory exclusion but were nonetheless not taxable to the extent that they merely compensate for a loss to human capital and represent no gain or profit. See I-1 C.B. at 92. Although the Service has not formally acquiesced in *Roemer*, it no longer contends that only physical injuries are encompassed within Section 104(a)(2). See Rev. Rul. 85-143, 1985-2 C.B. 55; Rev. Rul. 85-98, 1985-2 C.B. 51. Instead, the focus of the inquiry is whether a recovery for a claim of nonphysical injury compensates for a personal loss or represents an economic gain. See *Commissioner* v. *Miller*, 914 F.2d at 590.

"capital" (*Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. at 432 n.8) and does not represent gain or profit that "instead add[s] to [her] wealth." *Starrels* v. *Commissioner*, 304 F.2d at 576.

B. The Settlement Payments Received By Respondents Represent An Enhancement Of Their Wealth That Is Not Excluded From Income By Section 101(a)(2)

1. *The back pay awarded to respondents under Title VII of the Civil Rights Act of 1964 represented compensation for work already performed*

The payments received by respondents were made by their employer in settlement of sex-discrimination claims under Title VII of the Civil Rights Act of 1964, 42 U.S.C. 2000e *et seq.* The Title VII action was based on the allegation that the employer had altered salary schedules for various job categories in a manner that effected a gender-based discrimination in the payment of salaries. Pet. App. 19a-21a; C.A. App. 25-31. The complaint sought relief in the form of back pay for all affected female employees (including respondents) and a prospective, curative adjustment of the pay schedules. Pet. App. 22a; C.A. App. 33-34.

Title VII makes it an unlawful employment practice for an employer "to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's race, color, religion, sex, or national origin." 42 U.S.C. 2000e-2(a). An aggrieved employee may, if administrative remedies are unsuccessful, file suit in a district court. 42 U.S.C. 2000e-5(f)(1). If the court finds that the employer has engaged in an unlawful employment practice, it may enjoin the practice and "order such affirmative ac-

tion as may be appropriate, which may include, but is not limited to, reinstatement or hiring of employees, with or without back pay * * * or any other equitable relief as the court deems appropriate." 42 U.S.C. 2000e-5(g). Successful plaintiffs in a Title VII action involving salary discrimination may recover back pay in the amount of the differential between the salary received and the salary that would have been paid but for the discrimination. See *Rasimas* v. *Michigan Dep't of Mental Health*, 714 F.2d 614, 626 (6th Cir. 1983), cert. denied, 466 U.S. 950 (1984). Because Title VII allows only "equitable" relief, however, it is well settled that general compensatory damages and punitive damages are not available under Title VII. *E.g.*, *Walker* v. *Ford Motor Co.*, 684 F.2d 1355, 1363-1364 (11th Cir. 1982); *DeGrace* v. *Rumsfeld*, 614 F.2d 796, 808 (1st Cir. 1980); see *Patterson* v. *McLean Credit Union*, 491 U.S. 164, 182 n.4 (1989); *Great American Federal Savings & Loan Ass'n* v. *Novotny*, 442 U.S. 366, 375 (1979).[14]

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[14] Some Title VII plaintiffs can recover an award of future lost earnings (front pay). This remedy applies in cases where the employee-plaintiff was discharged and the statutory remedy of "reinstatement" (42 U.S.C. 2000e-5(g)) is not feasible. See, *e.g.*, *Shore* v. *Federal Express Corp.*, 777 F.2d 1155, 1158-1160 (6th Cir. 1985). Since the court in a Title VII salary discrimination case can order the defendant to pay a nondiscriminatory salary in the future, an award of front pay would seldom be appropriate. The plaintiffs here did not seek front pay, so no part of the settlement could represent front pay. A Title VII plaintiff may also recover a monetary award to account for lost fringe benefits such as vacation pay and pension benefits. See, *e.g.*, *Rasimas* v. *Michigan Dep't of Mental Health*, 714 F.2d at 626. The plaintiffs did not seek such fringe benefits in this case.

The only monetary relief available, and the only monetary relief sought, in the underlying Title VII action was "back pay to all affected female employees * * * in an amount * * * sufficient to eliminate discrimination" (Pet. App. 22a; C.A. App. 34). As the district court concluded, "the very core of the case was recovery of wage deficiencies" (Pet. App. 32a-33a).

Amounts received in settlement of a claim are treated for tax purposes as having the same character as the claim itself. *E.g.*, *Lyeth* v. *Hoey*, 305 U.S. 188, 196 (1938) (amount received by taxpayer in settlement of will contest is treated in same manner as if "the contest had been fought to a finish and petitioner had succeeded"); *Elrick* v. *Commissioner*, 485 F.2d 1049, 1058 (D.C. Cir. 1973); *Thomson* v. *Commissioner*, 406 F.2d 1006, 1008 (9th Cir. 1969); *Commissioner* v. *Murdoch*, 318 F.2d 414, 416 (3d Cir. 1963), cert. denied, 375 U.S. 879 (1963). The settlement payments received by respondents must therefore be regarded for tax purposes as an award of back pay, just as if the Title VII action had been concluded and the plaintiffs had prevailed.

Respondents claim that the payments under the settlement agreement represent "litigation benefits" (C.A. App. 71) rather than an award of back pay (Br. in Opp. 9; see *id.* at 4-5). This claim is without substance. The "litigation benefit" that was sought in the underlying Title VII action was an "order awarding back pay to all affected female employees" (Pet. App. 22a), and the only "litigation benefit" that respondents *could* properly have obtained in the form of a monetary recovery was an award of back pay. Respondents thus received precisely the "litigation benefit" that they sought: an award of back pay under Title VII.

2. *Compensation for work already performed represents an enhancement of wealth*

An award of back pay designed to recover "wage deficiencies" (Pet. App. 32a-33a) represents enhanced compensation for work already performed. Such enhanced compensation constitutes an "accession[] to wealth" rather than the recovery of lost personal "capital" (*Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. at 431, 432 n.8).

Under the rationale that no "gain or profit" is realized when compensation is received for personal "capital lost through injury" (see S.1384, 2 C.B. at 72), it is appropriate (for example) to recognize no income from a recovery for defamation of one's character or injury to one's "personal reputation." See, *e.g.*, *Hawkins* v. *Commissioner*, 6 B.T.A. 1023, 1024-1025 (1927). The receipt of monetary compensation in exchange for such lost "personal capital," which merely makes "the plaintiff whole as before the injury" (*id.* at 1025), represents an exchange without gain or profit. *Ibid.* See *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. at 432 n.8 ("[d]amages for personal injury are by definition compensatory only"). It is not supportable, however, to view the receipt of back wages (which would have been taxed as income if received currently during the course of employment) as compensation for lost personal capital. Back wages for work already performed do not compensate for a loss, but represent an "undeniable accession[] to wealth" (*id.* at 431) for the recipient.

For this reason, the Service has long ruled that amounts awarded as overtime compensation and unpaid minimum wages under the Fair Labor Standards Act are included in gross income. Rev. Rul. 72-268, 1972-1 C.B. 313; Rev. Rul. 55-203, 1955-1 C.B. 114; Mim. 6028, 1946-2 C.B. 130; I.T. 3742, 1945

C.B. 320; S.S.T. 393, 1940-1 C.B. 213. The Service has also concluded that back pay awarded under the National Labor Relations Act is included in gross income. Rev. Rul. 75-64, 1975-1 C.B. 16; Rev. Rul. 57-55, 1957-1 C.B. 304; Mim. 6040, 1946-2 C.B. 155. Similarly, this Court has held, in an unlawful discharge case, that back pay awarded under the National Labor Relations Act represents "wages" for purposes of the Social Security Act. *Social Security Board* v. *Nierotko*, 327 U.S. 358, 363-366 (1946).[15] An award of back pay is "merely a substitute for" (*Hort* v. *Commissioner*, 313 U.S. 28, 31 (1941)) compensation owed for services performed; it therefore constitutes income under Section 61(a). See *Hort* v *Commissioner*, 313 U.S. at 32.

Applying this same principle, the Service has correctly ruled that a Title VII back pay award is included in gross income. Rev. Rul. 72-341, 1972-2 C.B. 32. As the Service stated in its Ruling, "since the payments made by the corporation to the employees * * * were based on compensation that they otherwise would have received, the amount of the payments are includible in their gross incomes as compensation under Section 61 of the Code." *Ibid.*

The Service's longstanding ruling that Title VII back pay is included in gross income should be given substantial deference. See *National Muffler Dealers*

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[15] In *Nierotko*, the Court rejected the contention that a back pay award "is more appropriately classified as in the nature of damages and reparation for loss than as remuneration for service performed." *Nierotko* v. *Social Security Board*, 149 F.2d 273, 275 (6th Cir. 1945), aff'd, 327 U.S. 358 (1946). That rationale, rejected by this Court in *Nierotko*, is the very rationale applied by the court of appeals in this case in holding that Title VII back pay constitutes damages for personal injury. See Pet. App. 6a-10a.

Ass'n v. *United States*, 440 U.S. 472, 476-477 (1979). See also *Cottage Savings Ass'n* v. *Commissioner*, 111 S. Ct. 1503, 1509 n.7 (1991). An award of back pay under Title VII does not constitute a recovery of "damages, but rather is an integral part of the statutory equitable remedy." *Johnson* v. *Georgia Highway Express, Inc.*, 417 F.2d 1122, 1125 (5th Cir. 1969). See *Robinson* v. *Lorillard Corp.*, 444 F.2d 791, 802 (4th Cir.) (same), cert. dismissed, 404 U.S. 1006 (1971); *EEOC* v. *Detroit Edison Co.*, 515 F.2d 301, 308 (6th Cir. 1975) ("[b]ack pay in Title VII cases is considered a form of restitution, not an award of damages"), vacated and remanded on other grounds, 431 U.S. 951 (1977). Since a Title VII back pay award is not an award of damages that compensates for a prior loss of personal capital, but, instead, represents an undeniable accession to wealth in the form of deferred wages, it constitutes income to the taxpayer. See *Starrels* v. *Commissioner*, 304 F.2d at 576.

3. *The court of appeals erred in refusing to apply the foregoing principles*

a. The court of appeals did not dispute that the settlement payments in this case represented back pay for services already performed. See Pet. App. 9a-10a. Instead, the court concluded that these payments were excluded from income under Section 104(a)(2) on the theory that discrimination is an inherently "personal" injury, involving "individual rights and dignity of the person," and that *any* compensation associated with findings of discrimination therefore falls within the scope of the statute (Pet. App. 5a-8a). This ostensibly "literal" interpretation of the statute is incorrect.

It is well established that provisions exempting income from taxation "are to be construed narrowly." *United States* v. *Centennial Savings Bank*, 111 S. Ct. 1512, 1519 (1991) (citing, *e.g.*, *Commissioner* v. *Jacobsen*, 336 U.S. 28, 49 (1949)). Any unsatisfied claim of an individual—whether based on statute, contract, tort or other legal principle—could in some sense be said to be a "personal" claim. The issue that Section 104(a)(2) has addressed from its first enactment is whether the recovery obtained makes the individual whole for a preexisting personal loss or provides a benefit that increases the wealth of that individual. See pp. 10-15, *supra*. An award of back pay for work already performed, like any other "[c]ompensation for services" (26 U.S.C. 61(a)), is specifically included in "gross income" under Section 61(a) of the Code. Such an award represents an accession to wealth, rather than compensation for a loss, as the Service has consistently concluded.[18]

[18] Although the Service has ruled that damages for a physical injury that prevents an individual from engaging in employment may come within the Section 104(a)(2) exclusion (Rev. Rul. 85-97, 1985-2 C.B. 50; Rev. Rul. 61-1, 1961-1 C.B. 14), those rulings have no application here. In those situations, where the employee has been rendered incapable of performing work, the award of damages (including an award for lost future income due to the inability to perform work) represents "a restoration of [personal] capital" that is "by definition compensatory only." *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. at 432 n.8. By contrast, a back pay award for services already performed is an accretion to the taxpayer's wealth that "cannot be considered a restoration of capital for taxation purposes" (*ibid.*) and therefore does not fall within Section 104(a)(2).

Moreover, in a case where an employee has been rendered physically incapable of performing work, the award of damages is calculated with consideration of the fact that it is

b. In an effort to provide useful, categorical guidance, Treasury regulations adopted under Section 104(a)(2) indicate that the statute applies to amounts received "through prosecution of a legal suit or action based upon tort or tort type rights." Treas. Reg. § 1.104-1(c). The agency has long concluded, however, that back pay recoveries under Title VII and similar statutes are not excluded from gross income because they represent "remuneration for services." See Rev. Rul. 72-341, 1972-2 C.B. at 32. The court of appeals erred in disregarding the agency's application of its own regulation (Pet. App. 5a-10a).

The principle of compensation in the common law of torts is "that a person should be compensated fairly for injuries caused by the violation of his legal rights." *Carey* v. *Piphus*, 435 U.S. 247, 257 (1978). Mental and emotional distress and other similar suffering are compensable in tort actions. *Id.* at 264 & n.20; see *Memphis Community School Dist.* v. *Stachura*, 477 U.S. 299, 307 (1986) (compensatory

not subject to taxation. This is necessary to place the worker in the same situation as if she had not suffered the loss in the first place: "Since the damages award is tax-free, the relevant stream [of lost income] is ideally of *after-tax* wages and benefits." *Jones & Laughlin Steel Corp.* v. *Pfeifer*, 462 U.S. 523, 534 (1983). See also *Norfolk & W. R.R.* v. *Liepelt*, 444 U.S. 490, 493-498 (1980).

If a back pay award under Title VII were not subject to tax, such recoveries would similarly be reduced by the amount of the taxes saved. See *Johnston* v. *Harris County Flood Control Dist.*, 869 F.2d 1565, 1580 (5th Cir. 1989), cert. denied, 493 U.S. 1019 (1990); *Sears* v. *Atchison, T. & S.F. Ry.*, 749 F.2d 1451, 1456 (10th Cir. 1984), cert. denied, 471 U.S. 1099 (1985). The employer would then receive a windfall in the amount of the taxes saved. This windfall would create a perverse incentive for the employer to engage in salary discrimination in order to save taxes.

damages may include "such injuries as 'impairment of reputation . . ., personal humiliation, and mental anguish and suffering'" (quoting *Gertz* v. *Robert Welch, Inc.*, 418 U.S. 323, 350 (1974)). These types of compensatory damages for mental and emotional distress are not available under Title VII. See, *e.g.*, *DeGrace* v. *Rumsfeld*, 614 F.2d at 808. A statutory Title VII action thus differs significantly from the tort type rights encompassed within the regulations implementing Section 104(a)(2), and the agency has consistently so ruled.[17]

As this Court has often noted, the agency's interpretation of its own regulation is the "ultimate criterion" for its proper application and is entitled to "controlling weight" where "the meaning of the

[17] Respondents contend that a Title VII claim is "in the nature of tort" because it is not "based on contract." Br. in Opp. 15; see *id.* at 13. But respondents' conclusion does not follow from their premise. The mere fact that a claim is not a contract action does not necessarily make it a tort action. Moreover, the existence of the respondents' employment contracts underlies their claims for wages: the statutory duty not to discriminate, like other forms of legal protection afforded to employees, may be regarded as a condition of that contract implied in law. Indeed, back-pay claims typically are claims for wages prescribed by the employer's contracts of employment.

Respondents also seem to contend that if an action sounds in tort, it must be a personal injury action. Br. in Opp. 12-16. The exclusion for damages received "on account of personal injuries" is not an exclusion for all tort damages. Many tort claims do not involve injuries to the person, but rather injuries to property or other economic interests, *e.g.*, claims for injuries to property, fraud, tortious interference with a contract, and trade libel. Although all "personal injuries" for purposes of Section 104(a)(2) involve tort or tort-like claims, not all tort or tort-like claims involve personal injuries.

words used [in the regulation] is in doubt" (*Bowles* v. *Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945)). See *North Haven Board of Educ.* v. *Bell*, 456 U.S. 512, 538-539 n.29 (1982) ("In construing regulations, the Court normally defers to the agency's interpretation."); *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 565 (1980) (agency interpretation of its own regulation upheld "[u]nless demonstrably irrational"). The court of appeals thus plainly erred in purporting to *apply* this regulation—to conclude that respondents' claims were "tort type" in nature and therefore within the scope of Section 104(a)(2) (Pet. App. 5a, 8a-10a)—while choosing to *ignore* the agency's longstanding determination that back pay remedies constitute wage income within the express compass of Section 61(a). See also *Hort* v. *Commissioner*, 313 U.S. at 31-32.

Even if Title VII could properly be regarded as involving a "tort type" right within the meaning of the regulation, back pay would nonetheless not be excludable under Section 104(a)(2) because the injury suffered by respondents (and the injury for which they were compensated under Title VII) was not a personal injury, but rather an injury to their economic interests. See notes 16 & 17, *supra*. As this Court recognized in *Albemarle Paper Co.* v. *Moody*, 422 U.S. 405 (1975), the discrimination addressed by Title VII "deals with legal injuries of an economic character." *Id.* at 418.[18]

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[18] The Court also has recognized that "harassment leading to noneconomic injury can violate Title VII." *Meritor Savings Bank* v. *Vinson*, 477 U.S. 57, 65 (1986). See *Patterson* v. *McLean Credit Union*, 491 U.S. at 180 (racial harassment in the course of employment is actionable under Title VII). In such a case, however, back pay is not an available remedy. See *Meritor Savings Bank*, 477 U.S. at 77 (Marshall, J., concurring) ("In the 'pure' hostile environment case, where an employee files an EEOC complaint alleging sexual harassment in the workplace, the employee seeks not money damages but injunctive relief."); *Bundy* v. *Jackson*, 641 F.2d 934, 946 n.12 (D.C. Cir. 1981) (back pay is "irrelevant to the discriminatory environment issue").

In concluding that Title VII back pay does not constitute damages for personal injuries under Section 104(a)(2), the Fourth Circuit observed in *Thompson* v. *Commissioner*, 866 F.2d 709, 712 (1989), that a Title VII back pay award is "simply recovery for earned, but unpaid, wages" and represent "compensation for services rendered." The Tax Court had earlier reached the same conclusion in *Hodge* v. *Commissioner*, 64 T.C. 616, 619 (1975), observing that "[u]se of the adjective 'back' in the phrase 'back pay' indicates a recovery of wages which should have been paid but were not."[19] Compensation for wages "which

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[19] The Tax Court has followed its decision in *Hodge* in several other cases holding that Title VII back pay is not excludable under Section 104(a)(2). *Thompson* v. *Commissioner*, 89 T.C. 632, 644-648 (1987), aff'd, 866 F.2d 709 (4th Cir. 1989); *Sparrow* v. *Commissioner*, 57 T.C.M. (CCH) 816, 819-821 (1989), appeal pending, No. 90-1151 (D.C. Cir.); *Coats* v. *Commissioner*, 36 T.C.M. (CCH) 1650 (1977); but cf. *Downey* v. *Commissioner*, 97 T.C. 150, 164-170 (1991) (back pay award under Age Discrimination in Employment Act (ADEA), 29 U.S.C. 621-634, is excluded from income under Section 104(a)(2)). The Court of Claims has also held that Title VII back pay is not excludable under Section 101(a)(2). *Watkins* v. *United States*, 80-1 U.S.T.C. ¶ 9362 (Ct. Cl. 1980). Moreover, courts in Title VII cases have taken into account the fact that back pay will be included in the recipient's gross income in fashioning the back pay award. *Johnston* v. *Harris County Flood Control District*, 869 F.2d 1565, 1579-1580 (5th Cir. 1989), cert. denied, 493 U.S. 1019 (1990); *Sears* v. *Atchison, T. & S.F. Ry.*, 749

should have been paid but were not" falls squarely within the category of "[c]ompensation for services" that is expressly included in gross income under Section 61(a)(1) of the Internal Revenue Code.[20]

F.2d 1451, 1456 (10th Cir. 1984), cert. denied, 471 U.S. 1099 (1985); *Melani* v. *Board of Higher Educ.*, 652 F. Supp. 43, 48 (S.D.N.Y. 1986), aff'd mem., 814 F.2d 653 (2d Cir. 1987); see also *Gelof* v. *Papineau*, 829 F.2d 452, 455 (3d Cir. 1987) (ADEA back pay).

[20] Several courts have held that back pay awards under the Age Discrimination in Employment Act (ADEA), 29 U.S.C. 621-634, constitute damages for personal injuries that are excluded from income under Section 104(a)(2). *Redfield* v. *Insurance Co. of North America*, 940 F.2d 542, 545-547 (9th Cir. 1991); *Pistillo* v. *Commissioner*, 912 F.2d 145, 149-150 (6th Cir. 1990); *Rickel* v. *Commissioner*, 900 F.2d 655, 661-664 (3d Cir. 1990); *Downey* v. *Commissioner*, 97 T.C. 150, 164-170 (1991). Each of these cases involved an employee who was discharged by his employer due to unlawful age discrimination. The Ninth Circuit in *Redfield* and the Third Circuit in *Rickel* stated that their decisions were consistent with the Fourth Circuit's decision in *Thompson* because the plaintiff in an employee discharge case receives back pay related to the period *after* he was discharged from his job and, therefore, does not receive compensation for services already performed. *Redfield* v. *Insurance Co. of North America*, 940 F.2d at 546-547 & n.1; *Rickel* v. *Commissioner*, 900 F.2d at 664-665 n.16. There should be no distinction between the receipt of back pay for salary discrimination and for wrongful discharge. Both the ADEA and Title VII prohibit a variety of discriminatory employment practices that can give rise to back pay claims (*e.g.*, discriminatory salary differential, discharge, failure to promote, and failure to hire). See 29 U.S.C. 623(a); 42 U.S.C. 2000e-2(a). In all of these situations, back pay represents "compensation for services" that should have been paid but was not. See *Social Security Board* v. *Nierotko*, 327 U.S. at 363-366 (back pay awarded to employee who was wrongfully discharged by his employer for union activity constitutes wages for purposes of Social Security Act).

c. The court of appeals further erred in disregarding the fact that its ruling would place respondents in a *better* position "than they would have been [in] had the discrimination not occurred" (Pet. App. 9a; *id.* at 10a). The remedies available under Title VII are designed "to make persons whole for injuries suffered on account of unlawful discrimination." *Albemarle Paper Co.* v. *Moody*, 422 U.S. at 418. A Title VII back pay award is required to place the employee in the same economic position she would have achieved had she not been discriminated against in the first place. See *id.* at 418-421. The award, however, should not put the employee in "a better position than [she] would have enjoyed in the absence of discrimination." *Ford Motor Co.* v. *EEOC*, 458 U.S. 219, 234 (1982). See note 16, *supra*.

If respondents' employer had not discriminated against them, they would have received higher salaries and those salaries would have been included in their gross incomes. Requiring respondents to pay taxes on their back pay awards under Title VII simply places them in the same position as if they had not been discriminated against in the first place. By contrast, "[i]f the back pay award were excluded from gross income, [respondents] would be placed at an advantage over [their] male co-workers, who presumably reported their total earned wages as gross income." *Thompson* v. *Commissioner*, 866 F.2d at 712.

The back pay provisions of Title VII were modeled after the back pay provisions of the National Labor Relations Act, 29 U.S.C. 160(b). 110 Cong. Rec. 6549 (1964) (remarks of Sen. Humphrey); *id.* at 7214 (interpretive memorandum by Sens. Clark and Case). See *Albemarle Paper Co.* v. *Moody*, 422 U.S. at 419 & n.11. When Congress enacted Title

VII in 1964, it had already been established that back pay awarded under the National Labor Relations Act was included in gross income for tax purposes. See Rev. Rul. 57-55, 1957-1 C.B. 304; Mim. 6040, 1946-2 C.B. 155; *Social Security Board* v. *Nierotko*, 327 U.S. at 363-366 (back pay constitutes wages for purposes of the Social Security Act). In modeling the back pay provisions of Title VII on the parallel provisions of the earlier statute, Congress did not seek to alter the corresponding conclusion that back pay awarded under Title VII also would be included in gross income and subjected to tax.

d. The court of appeals erred in relying on decisions of this Court dealing with various issues under other statutory remedies for "injuries resulting from invidious discrimination" (Pet. App. 6a). None of the cases cited by the court of appeals even remotely addresses the question whether the injury involved in a Title VII action is a personal injury within the meaning of Section 104(a)(2) of the Internal Revenue Code.

The court of appeals relied (Pet. App. 6a) on *Wilson* v. *Garcia*, 471 U.S. 261 (1985), which held that all claims brought under 42 U.S.C. 1983 should be characterized for statute of limitations purposes as personal injury actions. 471 U.S. at 276, 280. The issue in *Wilson* was what state statute of limitations should be applied to Section 1983 claims. The Court concluded that "federal interests in uniformity, certainty, and the minimization of unnecessary litigation" require that *all* Section 1983 claims be characterized in the same way for limitations purposes and that courts should "select, in each State, the one most appropriate statute of limitations for all § 1983 claims." 471 U.S. at 275. The Court concluded that "the tort action for the recovery of damages for personal injuries is the best alternative available" for characterizing the numerous and various types of recoveries subsumed within Section 1983. 471 U.S. at 276.

The rationale for adopting a blanket rule for statute of limitations purposes under 42 U.S.C. 1983 has no application in the context of Section 104(a)(2). The interests in uniformity, certainty, and the minimization of unnecessary litigation with which the Court was concerned in *Wilson* are absent in the Section 104(a)(2) context. There is no basis whatever to believe that Congress intended that all claims that arise under Section 1983 (which "encompass numerous and diverse topics and subtopics," 471 U.S. at 273) would be characterized as "personal injury" recoveries for tax purposes. For example, this Court recently held that suits for violations of the Commerce Clause may be brought under Section 1983. *Dennis* v. *Higgins*, 111 S. Ct. 865 (1991). Under the rationale of *Wilson* v. *Garcia*, *supra*, such suits would be treated as personal injury actions for statute of limitations purposes. That hardly means that damages that might be recovered in such suits constitute damages for personal injuries for purposes of Section 104(a)(2).

The court of appeals' reliance (Pet. App. 6a) on *Goodman* v. *Lukens Steel Co.*, 482 U.S. 656 (1987), aff'g 777 F. 2d 113 (3d Cir. 1985), is similarly misplaced. In *Goodman*, the Third Circuit held that *Wilson* v. *Garcia* compelled the conclusion that all actions under 42 U.S.C. 1981 should be governed by the statute of limitations for personal injury actions (777 F. 2d at 119-120). This Court agreed. 482 U.S. at 660-662. The *Goodman* decision sheds no light on the proper interpretation of Section 104(a)(2) of the Internal Revenue Code.

The court of appeals also cited (Pet. App. 7a) dictum in *Curtis* v. *Loether*, 415 U.S. 189, 195-196 n.10 (1947), that suggested that an "action to redress racial discrimination may * * * be likened to an action for defamation or intentional infliction of mental distress." In *Curtis*, the Court held that the Seventh Amendment right to jury trial applies to a damages action under the Fair Housing Act, 42 U.S.C. 3601 *et seq.*, because such an action "sounds basically in tort" and "involves rights and remedies of the sort typically enforced in an action at law." 415 U.S. at 195.[21] The Court noted by contrast (*id.* at 196-197 & n.13), however, that it has consistently been held that there is no right to a jury trial in a Title VII action (*e.g.*, *Johnson* v. *Georgia Highway Express, Inc.*, 417 F.2d at 1125; *Robinson* v. *Lorillard Corp.*, 444 F.2d at 802; see also *Great American Federal Savings & Loan Ass'n* v. *Novotny*, 442 U.S. at 375; *Albemarle Paper Co.* v. *Moody*, 422 U.S. at 442-444 (Rehnquist, J. concurring)) because back pay awards under Title VII are "an equitable remedy" and therefore "contrast[] sharply" with tort type claims and other actions at law that permit recovery of "actual and punitive damages." 415 U.S. at 197. Far from supporting the contention that Title VII back pay constitutes a "tort type" claim to be excluded from income under Section 104(a)(2), this Court's decision in *Curtis* points quite clearly to the opposite conclusion.

There was, accordingly, no tenable justification for the court of appeals to depart from the Service's

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[21] The Court also analogized a violation of the Fair Housing Act to "the common-law duty of innkeepers not to refuse temporary lodging to a traveler without justification." 415 U.S. at 195-196 n.10.

longstanding determination that back-pay awards under statutes such as Title VII are included within the taxpayer's gross income as compensation for services.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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NOVEMBER 1991

☆ U. S. GOVERNMENT PRINTING OFFICE: 1991 312-524 45166